



## A Dollar Borrowed is a Dollar Earned

Posted by [Pierluigi Oliverio](#) on Monday, April 12, 2010

Last week, I attended budget meetings in council districts 9 and 10 as well as the labor unions' budget meeting at the Tully library. The people that attended this meeting were mostly union members and city council staff. It was admitted at the meeting that significant layoffs were inevitable since the deficit is enormous.

Ideas were presented on what money-saving measures could be implemented and what new sources of revenue could be found to balance the \$118 million budget gap. Ideas ranged from replacing natural lawns in parks with artificial turf (lower ongoing maintenance costs, but more costly upfront) to turning down the air conditioning at city hall during the summer. Others included putting banner ads on the city website for advertising revenue and charging owners of vacant property a fee/fine since they do not have a tenant.

Although many "creative" ideas were mentioned, none of them seemed to really tackle or help offset our deficit of \$118 million—nor did the suggestions even get close to \$1 million. Other thoughts were a "crash tax." For example, if you were to get into a car accident and police or fire truck showed up, then you would pay \$500 to \$2,000, since you used city services. Another idea would have the city attorney sue code enforcement violators for fines owed rather than placing liens on their property as we do today.

There was a proposal advocating outsourcing. Really?! This concept would outsource the workers compensation program to a third party since it would be cheaper and faster than if the city continues to run it. Interesting that it makes sense for this program but not outsourcing city hall janitorial to keep swimming pools open!?

The major theme at the meetings, however, was about borrowing more money. There was a discussion advocating pension obligation bonds (POBs), which is an arbitrage scheme where the city borrows tens of millions of dollars in the bond market, and then we give that money to the city retirement funds, hoping the retirement board

investment strategy earns more money than the city pays for its bonds. If the retirement fund does make more money than we owe the bond holders (and the associated investment fees), then the city can spend the difference. However if the investment return is lower than the city's cost, then city loses even more money. Similar to a cash advance on a credit card and then investing the cash advance amount in the stock market and hoping that the stock will have a higher return than the credit card interest rate. Also, by issuing POB's the pension obligation, which can vary over time due to investment returns, becomes a hard liability in the sense that debt service is fixed for 30 plus years.

Probably, the «best» idea, was to borrow money by taking out tens of millions of dollars in one-year notes/commercial paper to pay for ongoing city services. Then, when these notes come do in 2011, we would issue more notes to cover the original 2010 notes. When the 2011 notes come do in 2012, we would issue more notes again for 2013 and so on or until city tax revenue came back.

First, the revenues will not come back to pay for existing city services since pension obligations as a percentage of the general fund will continue to grow faster than revenue coming into city coffers. Second, this bright idea is like a consumer who charges up one credit card and then gets another credit card to pay off the previous one and so on. Issuing commercial paper to cover ongoing operations would hurt our bond rating and banks that provide San Jose with Letters of Credit will look at the city as irresponsible. I cannot recommend this type of borrowing/financing for city services as it passes on the problem to another eneration. We are partly suffering now because of the lack of tough decisions by previous elected officials at all levels of government.

“We should avoid ungenerously throwing upon posterity the burdens that we ourselves ought to bear.»—George Washington

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